

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIF



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In the Matter of Application of  
CALIFORNIA-AMERICAN WATER  
COMPANY (U 210 W) for an order  
authorizing it to increase its rates for water  
service in its Los Angeles District to increase  
revenues by \$2,020,466 or 10.88% in the year  
2007; \$634,659 or 3.08% in the year 2008;  
and \$666,422 or 3.14% in the year 2009.

A.06-01-005  
(Filed January 9, 2006)

**REPLY COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES  
ON ALTERNATE PHASE ONE PROPOSED DECISION**

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August 20, 2007

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**CERTIFICATE OF SERVICE**

Pursuant to Rule 14.3 of the Commission's Rules of Practice and Procedure (Rules), the Division of Ratepayer Advocates (DRA) submits these Reply Comments on the Alternate Proposed Decision of Commissioner Peevey (Alternate)<sup>1</sup> and responds to the Comments of California-American Water Company (Cal-Am) on the Alternate.<sup>2</sup>

## **I. INTRODUCTION**

This is the second proceeding in which DRA and a Class A water company have proposed a mechanism for decoupling commodity sales from revenues as part of new conservation-oriented rate design. The Commission rejected the first attempt which was between DRA and California Water Service Company (Cal Water).<sup>3</sup> It has become apparent that the structure and content of the regulatory accounting mechanisms proposed to accompany water conservation rates, and the effect of those mechanisms on return on equity (ROE), continue to pose a challenge for the Commission. While DRA continues to support the Settlement Agreement on Rate Design Issues between the Division of Ratepayer Advocates and California-American Water Company (Rate Design Settlement or Phase II Settlement), DRA recommends in the alternative that Cal-Am's conservation rates for the Los Angeles District be considered in the Conservation Order Instituting Investigation, I.07-01-022 (OII). The Commission should therefore order Cal-Am to immediately file a WRAM and conservation rate design proposal in Phase 1B of the OII,<sup>4</sup> and it should file a single-quantity rate design in this proceeding based on the soon-to-be-adopted revenue requirement so that rates can be implemented while the Commission considers conservation rates in the OII.

As discussed in DRA's Comments on the Alternate, however, the record affords no basis for the Commission's adoption of a Conservation Loss Adjustment Mechanism (CLAM) included in both the Alternate and in the Proposed Decision of ALJ Walwyn (mailed 5/7/07, Revision 4) (Walwyn PD).<sup>5</sup> Cal-Am

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<sup>1</sup> Alternate Proposed Decision of Commissioner Peevey (mailed July 24, 2007 and revised on August 9, 2007 (Alternate).

<sup>2</sup> Comments of California-American Water Company (U 210 W) on the Alternate Proposed Decision of Commissioner Peevey (August 13, 2007) (Cal-Am Comments).

<sup>3</sup> D.06-08-011, *mimeo*, at 17-21.

<sup>4</sup> The scope of Phase 1B of I.07-01-022 includes consideration of an ROE adjustment with regard to the conservation rate design mechanisms of Suburban Water Systems, Park Water Company, California Water Service Company, San Jose Water Company, and Golden State Water Company. Administrative Law Judge's Ruling Consolidating Application of San Jose Water, Modifying Schedule, and Addressing Phase I Hearings, I.07-01-022 (May 29, 2007) at 3-5.

<sup>5</sup> Proposed Decision of ALJ Walwyn (mailed May 7, 2007, and revised on August 9, 2007). *See, e.g.*, Comments of the Division of Ratepayer Advocates on Alternate Phase One Decision (August 13, 2007) (DRA Comments) at 8. DRA notes that its Comments on the Alternate compared the Alternate PD to the original Walwyn PD mailed on May 7, 2007, rather than to "Revision 4" of the Walwyn PD distributed to the service list on August 9, 2007. DRA's understanding is that the main difference between the 5/7/07 Walwyn PD and Revision 4 of the Walwyn PD is the inclusion of the CLAM discussion that appears on pages 43 to 46 of Revision 4. Thus, in DRA's statement of support for the Walwyn PD discussed in DRA's Comments on the Alternate, DRA clarifies that it does not support the  
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has not cited any record evidence that would cure the legal errors discussed in DRA's Opening Comments.<sup>6</sup> Thus, the Proposed Decisions' "policy preference" for a CLAM and the conclusion that a CLAM would not require an ROE adjustment continue to be unsupported by the record, are essentially arbitrary and capricious, and would violate the parties' due process rights.

DRA is particularly concerned that both Proposed Decisions adopt conclusions about the effect of a CLAM on return on equity without any factual or record support,<sup>7</sup> thus prejudging an aspect of an important issue that, for almost all other Class A companies, will be decided in Phase 1B of the OII.<sup>8</sup> If the Commission wants to express a "policy preference" for a CLAM, the Commission should refrain from opining on how a CLAM will affect ROE absent an analytical record, and should eliminate any conclusions on the effect of a CLAM on ROE from both Proposed Decisions, and defer this issue to I.07-01-022 as proposed in DRA's Opening Comments on the Alternate.<sup>9</sup>

In addition, DRA is extremely disappointed that Cal-Am is now ignoring a settlement that parties labored so intensively to develop, and furthermore that, in supporting a CLAM, Cal-Am has decided to embrace a contradictory position.<sup>10</sup> DRA strongly urges Cal-Am to reconsider its position and to either publicly support the terms of the settlement, or publicly and aggressively advocate consideration of regulatory accounting mechanisms such as the WRAM or CLAM, and any associated ROE impacts, in Phase 1B of the Conservation OII. DRA notes that in signing the Rate Design Settlement, Cal-Am committed itself to supporting the agreement in subsequent Commission proceedings. DRA is disappointed that apparently Cal-Am no longer believes itself bound by its earlier commitments.

In sum, DRA continues to support adoption of the Rate Design Settlement, either with the ROE adjustment determined in ALJ Walwyn's PD, or with deferral of the ROE issue to Phase 1B of the OII. In the alternative, DRA supports considering all of these conservation-related issues in the Conservation OII.

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discussion of a CLAM, particularly the determination that no ROE adjustment would be appropriate if the parties negotiated a CLAM.

<sup>6</sup> DRA Comments at 4-9.

<sup>7</sup> Alternate at 37.

<sup>8</sup> See, *supra*, note 4.

<sup>9</sup> See DRA Comments at Appendix.

<sup>10</sup> See, *infra*, Section III.

## **II. THE COMMISSION SHOULD CONSIDER ALL REGULATORY ACCOUNTING MECHANISMS AND THEIR ROE IMPACTS IN THE CONSERVATION OII**

Cal-Am supports the Alternate’s conclusion that the WRAM, the modified cost balancing account (MCBA), and “conservation risks” should be considered in an industry-wide proceeding.<sup>11</sup> Cal-Am states, for example:

A Commission finding in this proceeding that implementation of a WRAM warrants a substantial return on equity reduction would rashly prejudge the issue. The Proposed Decision makes significant assumptions about the impact of a WRAM and MCBA, even though those regulatory mechanisms have not yet been reviewed in this proceeding.<sup>12</sup>

Yet Cal-Am “accepts” the Commission’s “recommendation” of a CLAM.<sup>13</sup> Given the reality that the particulars of a CLAM that would be feasible for Cal-Am’s Los Angeles District are largely unknown and have not been reviewed by the Commission, the Proposed Decisions themselves are erroneously making very “significant assumptions about the impact” of a CLAM on ROE.

As DRA discussed in its Opening Comments on the Alternate, the development of a CLAM is likely to be neither straightforward nor facile. Rather than encouraging the parties to enter into another lengthy negotiation process to construct a CLAM (even assuming that DRA would participate in additional negotiations), the Commission should allow all of the potential regulatory accounting mechanisms – a “full” WRAM, a CLAM, a Monterey-style WRAM – and the effects of these mechanisms on ROE to be considered in one, industry-wide proceeding, the Conservation OII. As discussed in Section III, below, DRA must note that, even if the Commission adopts this recommendation, it is unclear whether DRA would be willing to jointly develop any conservation rates with Cal-Am in the OII unless Cal-Am reconsiders its position and publicly supports moving these issues to the Conservation OII.

## **III. CAL-AM’S RECOMMENDATIONS ARE INCONSISTENT WITH THE PARTIES’ RATE DESIGN SETTLEMENT AGREEMENT**

As noted earlier, DRA is disappointed that Cal-Am has not stood by the Phase II Rate Design Settlement. Without any expression of support, or even mention, of the Rate Design Settlement, Cal-Am now appears to support the CLAM discussed in the Proposed Decisions. As stated in its Comments:

California American Water accepts [the Commission’s CLAM] recommendation and has already begun considering the parameters of such a mechanism. As part of the second phase of this proceeding, California American Water will develop a methodology for measuring

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<sup>11</sup> Cal-Am Comments at 1-2.

<sup>12</sup> Cal-Am Comments at 2.

<sup>13</sup> Cal-Am Comments at 2.

the changes in water sales due to conservation and a mechanism to address cost underrecovery.<sup>14</sup>

Cal-Am's support for a CLAM is clearly inconsistent with the Rate Design Settlement to which it has already committed. The Commission should not accept Cal-Am's newfound willingness to develop a CLAM because it violates the spirit and the underlying premises of the Commission's settlement processes. If the Commission accepts Cal-Am's offer to develop a CLAM, it will be complicit in, and even reward, Cal-Am's failure to act in good faith and failure to observe professional courtesies.

In fact, DRA had reservations about the very broad WRAM request in Cal-Am's application because it seemed to benefit the company at the expense of the ratepayer. Cal-Am then worked with DRA to jointly develop and propose a more balanced mechanism that is presented in parties' proposed Phase II Settlement, a mechanism that is nevertheless broader than the CLAM discussed in the Proposed Decisions. Having negotiated a WRAM and taken the risk that the Commission could find that a broad mechanism lowers risk, Cal-Am now dismisses that WRAM as being inappropriate for adoption in Phase II of this proceeding.

Until ALJ Walwyn's PD favoring an ROE adjustment was released, Cal-Am and DRA were united in their willingness to implement aggressive conservation rates in this rate case cycle, to take on the symmetrical risks associated with a full WRAM, and to bear the risks associated with letting the Commission determine the appropriate ROE adjustment, if any. After ALJ Walwyn's PD was issued, however, and despite knowing early in the proceeding that the effect of a WRAM on ROE would be considered, Cal-Am changed course and urged the Commission to address ROE in an industry-wide proceeding. Now Cal-Am goes even further by essentially urging rejection of the WRAM in the Rate Design Settlement, and agreeing to develop a CLAM in its place. DRA, however, continues to support adoption of the settlement, either with the ROE adjustment determined in the Walwyn PD, or with deferral of the ROE issue to Phase 1B of the OII. In the alternative, DRA supports considering all of these conservation-related issues in the Conservation OII.

Unfortunately, considering Cal-Am's apparent willingness to jettison the Rate Design Settlement it worked extensively with DRA to develop, even if the Commission moves these issues into the Conservation OII, DRA would now have to consider whether to restart negotiations with Cal-Am when it is possible that the company would not fully honor a settlement after it has been negotiated. DRA urges Cal-Am to publicly support either the settlement as proposed, or consideration of all outstanding conservation-related issues, including ROE impact, in the OII.

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<sup>14</sup> Cal-Am Comments at 3.

#### **IV. THERE IS NO BASIS FOR THE CONCLUSION THAT A CLAM WOULD NOT REQUIRE AN ROE ADJUSTMENT**

Neither the Proposed Decisions nor Cal-Am have identified any mention of a CLAM in the record, much less an analysis of the ROE impact of a CLAM, rendering the Proposed Decisions vulnerable to legal challenge. Cal-Am makes a conclusory statement:

While a CLAM would address the risk of decreased revenues due to conservation, it would not reduce any of California American Water's currently existing risk. Since there is no reduction in risk, there is no reason to adjust California American Water's return on equity.<sup>15</sup>

Without a clear understanding of how a CLAM would work, it is mere speculation to conclude that no ROE adjustment is necessary. Furthermore, Cal-Am argues on the one hand that an ROE adjustment for a full WRAM is not acceptable because "the record evidence on this issue is scant at best and was produced in haste,"<sup>16</sup> and simultaneously argues on the other hand that the CLAM is acceptable, despite the absence of record, even a record "produced in haste." The Commission should therefore eliminate from the Proposed Decisions any reference to ROE in the discussion of a CLAM.

#### **V. CONCLUSION**

For the reasons discussed above and in DRA's Opening Comments on the Alternate, DRA urges the Commission to eliminate the discussion of a Conservation Loss Adjustment Mechanism from both Proposed Decisions.<sup>17</sup> Most importantly, even if the Commission adopts a CLAM as a policy preference, it is crucial that the Commission refrain from prejudging the issue of ROE. DRA therefore recommends that any reference to ROE in conjunction with a CLAM, if not the entire discussions about CLAMs, be eliminated from the Proposed Decisions.

Furthermore, if the conservation rates, WRAM, and MCBA negotiated in the Rate Design Settlement are not adopted, Cal-Am should implement single-quantity rates in the Los Angeles District until the Commission addresses these issues in the Conservation OII. Thus, the Phase I decision should order Cal-Am to follow standard rate design and submit a single-quantity rate design based on the adopted revenue requirement in Phase II, as well as order Cal-Am to immediately submit in the OII a conservation rate design and WRAM proposal, preferably along the lines of the Rate Design Settlement. Cal-Am's immediate submission in the OII is crucial if the Commission is to have conservation rates for the Los Angeles District adopted before the summer of 2008.

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<sup>15</sup> Cal-Am Comments at 3.

<sup>16</sup> Cal-Am Comments at 3.

<sup>17</sup> For proposed language, see the Appendix to DRA's (Opening) Comments.

Respectfully submitted,

/s/ NATALIE D. WALES

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August 20, 2007

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served a copy of “**REPLY COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES ON ALTERNATE PHASE ONE PROPOSED DECISION**” in **A.06-01-005** by using the following service:

☒ **E-Mail Service:** sending the entire document as an attachment to all known parties of record who provided electronic mail addresses.

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Executed on **August 20, 2007** at San Francisco, California.

/s/ MARTHA PEREZ
Martha Perez

**N O T I C E**

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